FAIR POLITICAL PRACTICES COMMISSION

Memorandum

To: Chairman Randolph, Commissioners Downey, Karlan, Knox and Swanson

From: C. Scott Tocher, Commission Counsel
Luisa Menchaca, General Counsel

Re: Section 89519 - Surplus Funds: Prenotice Discussion of Proposed Regulation 18951

Date: May 20, 2003

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The use of campaign funds and the prohibition on their expenditure for "personal use" is governed by Government Code sections 89510 through 89522. The expenditure of campaign funds by candidates must be, at a minimum, reasonably related to a political, legislative, or governmental purpose associated with the candidate's office. Where an expenditure, however, confers a substantial personal benefit on a candidate, the expenditure must be directly related to a political, legislative, or governmental purpose. Where campaign funds become "surplus" campaign funds, the personal use law further limits their expenditure. An interpretive regulation was adopted by the Commission in 1990 to specify when candidates' funds become surplus under different scenarios. The Office of Administrative Law, however, rejected the regulation and it was never refiled.

Staff proposes the Commission renotice the former regulation (regulation 18587, Exhibit 3) to codify the staff advice which has been consistent with that former regulation, and to discuss new issues.

I. OVERVIEW OF PERSONAL USE

Article 4 of Chapter 9.5 of the Political Reform Act (the "Act")[1] prescribes the rules applicable to the permissible use of campaign funds. "Campaign funds" include any contributions, cash, cash equivalents, and any other assets received or possessed by a recipient committee, including a recipient committee controlled by a candidate. (§§ 89511, subd. (b)(1) – (2), 82013, and 82016.) Specifically, sections 89510-89518 (commonly known as "personal use law") generally seek to eliminate the personal benefit a candidate can derive from expending his or her campaign contributions. "All contributions deposited into the campaign account shall be deemed to be held in trust for expenses associated with the election of the candidate or for expenses associated with holding office." (§ 89510, subd. (b).)

[1] All references are to the Government Code, unless otherwise specified.

Section 89510 was amended by Proposition 34 to provide that a candidate may only accept contributions in accordance with the provisions set forth in Chapter 5 and for the "purposes" set forth in Chapter 5. SB 34 (Burton) further amended the trust provision to provide instead, that candidates may only accept a contribution in accordance with the "limits" provided in Chapter 5 and "for expenses associated with the election of the candidate or for expenses associated with holding office." (Stats. 2000, Ch 102.) This is consistent with the "trust" provision in the Act that existed prior to the enactment of Proposition 34.[2]

Section 89512 provides the general rules for expenditures made by candidates[3] from campaign funds:

> "An expenditure to seek office is within the lawful execution of the trust imposed by Section 89510 if it is reasonably related to a political purpose. An expenditure associated with holding office is within the lawful execution of the trust imposed by Section 89510 if it is reasonably related to a legislative or governmental purpose. Expenditures which confer a substantial personal benefit[4] shall be directly related to a political, legislative, or governmental purpose." (Footnote added.)[5]

Accordingly, to be permissible, all campaign expenditures must at least bear a reasonable relationship to a political, legislative or governmental purpose. This law applies equally to state and local candidates.

When a candidate withdraws from or is defeated in an election, or leaves office[6], funds left over in his or her campaign committee are characterized as "surplus funds." The use of surplus funds is subject to greater restrictions than the use of campaign funds

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[2] Prior to Proposition 34, section 89510(b) provided that "[a]ll contributions deposited into a campaign account shall be deemed to be held in trust for expenses associated with the election of the candidate to the specific office for which the candidate has stated, pursuant to section 85200, that he or she intends to seek or expenses associated with holding that office."

[3] Section 89511.5 sets forth specific rules for incumbents with respect to the reimbursement of expenses.

[4] "Substantial personal benefit" includes an expenditure of campaign funds which results in a direct personal benefit with a value of more than $200 to a candidate. (§ 89511(b)(3); Reg. 18960.)

[5] Section 89512.5 specifies the standard for non-candidate committees.

[6] A candidate leaves office when the candidate's term has ended, or he or she resigns. (*Gould* Advice Letter, No. A-99-241.) A candidate is deemed to be a defeated candidate if he or she loses or withdraws from the election, or opens a committee for the election and decides not to run. (*Willet* Advice Letter, No. A-96-103.) Staff has advised that funds of a defeated candidate are considered surplus at the end of the post-election period of the election for which the campaign funds were raised. (*Fishburn* Advice Letter, No. A-01-305.) That conclusion is embodied in subdivision (b) of the draft regulation.

that are not surplus funds. These restricted uses are found at section 89519, attached as Exhibit 1, and include:

• Outstanding campaign debts or elected officer's expenses;

• Repayment of contributions;

• Donations to any bona fide charitable, educational, civic, religious, or similar tax-exempt, nonprofit organization, if no substantial part of the proceeds will have a material financial effect on the candidate, any member of his or her immediate family, or the campaign treasurer;

• Contributions to a political party committee, so long as the funds are not used to make contributions in support of or in opposition to a candidate for elective office;

• Contributions to support or oppose any candidate for federal office, or any candidate in another state, or any ballot measure;

• Professional services, such as legal or accounting services; and

• A home or office security system, if the candidate has received threats to his or her physical safety and other conditions are met.

II. PROPOSED REGULATION 18951.

Staff proposes the Commission notice for adoption regulation 18951 (Exhibit 2) to assist in the implementation of section 89519. Generally, the regulation seeks to define terms in the statute, describe implementation in common factual scenarios and establish the parameters in which the statute operates. Each subdivision and its respective issue is discussed below in the order it appears in the draft regulation.

A. Subdivision (a) - Application to Post-1989 Funds

Subdivision (a) applies to funds raised after January 1, 1989. Before delving too deeply into this subdivision, it is helpful to understand the history of statutes aimed at addressing surplus funds.

1. 1990. Pre- versus Post-1989 Funds on Hand

Effective January 1, 1990, the Act was amended by Senate Bill 1431 (Ch. 1452, Stats. 1989) to include new provisions which regulated the appropriate use of campaign funds. These provisions were formerly governed by provisions of the Elections Code, and prior to this law the Commission did not have jurisdiction over this area of the law. (*Craven* Advice Letter, No. A-97-373a.)

Senate Bill 1431 established two rules governing surplus funds, depending on when the funds were raised. The first rule, contained then in former Elections Code section 12400, the more permissive of the two, governed funds raised *before* January 1, 1989.[7] At that time, funds raised on or before January 1, 1989, were subject to interpretation by the Attorney General. (*Craven* Advice Letter, *supra*, *citing* Staff Memorandum, Adoption of Proposed Regulation 18587 - Disposition of Surplus Campaign Funds, dated October 26, 1990.) As long as these funds were not commingled with funds raised after January 1, 1989, the funds were subject to the Elections Code provisions. (*Vonada* Advice Letter, No. A-92-360.) For funds raised *after* January 1, 1989, however, section 85807 of the Government Code applied:

> "**85807.** Upon leaving any elected office, or at the end of the postelection reporting period following the defeat of a candidate for elective office, whichever occurs last, campaign funds raised after January 1, 1989, under the control of the former candidate or elected officer shall be considered surplus campaign funds and shall be disclosed pursuant to the requirements of Chapter 4 (commencing with Section 84100) and shall be made only for the following purposes:
> "(a) The payment of outstanding campaign debts or elected officer's expenses.
> "(b) The pro rata repayment of contributions.
> "(c) Donations to any bona fide charitable, educational, civic, religious, or similar tax-exempt, nonprofit organization, where no substantial part of the proceeds will have a material financial effect on the former candidate or elected officer, any member of his or her immediate family, or his or her campaign treasurer.

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[7] Former Elections Code section 12400 stated:

"**12400.** Upon leaving any elective office, or at the end of the postelection reporting period following the defeat of a candidate for elective office, whichever occurs last, surplus campaign funds raised prior to January 1, 1989, under the control of the former candidate or officeholder or his or her controlled committee shall be used or held for the following purposes:

"(a) The repayment of personal or committee loans or other obligations if there is a reasonable relationship to a political, legislative, or governmental activity.

"(b) The payment of the outstanding campaign expenses.

"(c) Contributions to any candidate, committee, or political party, except where otherwise prohibited by law.

"(d) The pro rata repayment of contributors.

"(e) Donations to any religious, scientific, educational, social welfare, civic, or fraternal organization no part of the net earnings of which inures to the benefit of any private shareholder or individual or to any charitable or nonprofit organization which is exempt from taxation under subsection (c) of Section 501 of the Internal Revenue Code or Section 17214 or Sections 23701a to 23701j, inclusive, or Section 23701l, 23701n, 23701p, or 23701s of the Revenue and Taxation Code.

"(f) Except where otherwise prohibited by law, held in a segregated fund for future political campaigns, not to be expended except for political activity reasonably related to preparing for future candidacy for elective office."

Section 12400 of the Elections Code subsequently was renumbered as section 20300 of the Elections Code, where it remained until its repeal by Proposition 208 in 1996.

> "(d) Contributions to a political party or committee so long as the funds are not used to make contributions in support of or opposition to a candidate for elective office.
> "(e) Contributions to support or oppose any candidate for federal office, any candidate for elective office in a state other than California, or any ballot measure."

This section was renumbered to 89519 of the Government Code the following year (Ch. 84, Stats. 1990). In 1990, the Commission adopted regulation 18587, interpreting these laws. The regulation, however, did not undergo the complete rulemaking process when the Office of Administrative Law disapproved the Commission's regulatory action in February of 1991.[8] While the regulation, therefore, was never formally effective, staff advised that it represented Commission policy concerning surplus campaign funds. (*Craven* Advice Letter, *supra*.) In 1993, Elections Code section 12400, dealing with pre-1989 funds, and Government Code section 89519 both were amended to provide an additional permissible use for the installment of an alarm or other security system. (Ch. 1143, Stats. 1993.)

In 1996, however, the voters passed Proposition 208 and amended section 89519, under which a candidate had to distribute all surplus campaign funds within 90 days after his or her withdrawal, defeat, or election to office. The proposition repealed the two prior statutes governing surplus funds (Elections Code section 20300 (formerly section 12400 - see footnote 7) and Government Code section 89519) and enacted just one law.

Not long after its passage, Proposition 208 was enjoined from enforcement, including section 89519. While the final determination was pending in court, the voters passed Proposition 34, which repealed Proposition 208's language and reenacted in a slightly different form the earlier version of section 89519. One perhaps critical component missing from the Proposition 34 enactment is that it failed to address surplus funds raised *prior* to January 1, 1989. Since Proposition 208 repealed the former Elections Code section (20300) that addressed these contributions and this section was not reenacted by Proposition 34, no statute currently in the Act addresses surplus funds that are raised *prior* to January 1, 1989.[9]

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[8] By letter of February 19, 1991, the Office of Administrative Law issued a "Decision of Disapproval of Regulatory Action" for "noncompliance with the 'consistency' standard." Two months after the regulation was disapproved, the Court of Appeal of the State of California, Third Appellate District, issued an unpublished decision in *FPPC v. Office of Administrative Law*, in which the court concluded that the Commission is exempt from the standard review process by the OAL. Currently, the OAL examines each regulation transmitted to it for filing and determines whether it complies with the form and style prescribed by the Secretary of State only. Consistent with the Commission's approval of regulation 18587 in 1990, staff believes the regulation is consistent with the statute's language and intent and will be reviewed by the OAL only as to form and style.

[9] Also, prior to the passage of Proposition 34, section 89519 required that repayment of contributions from surplus funds be done on a pro rata basis. Pursuant to amendment of this section by Proposition 34, there is no longer a pro rata requirement for the repayment of contributions made from surplus funds. (§ 89519; *Cassidy* Advice Letter, No. I-01-296.)

2. Subdivision (a) of Regulation 18951.

Subdivision (a) of the regulation sets forth the definition of "surplus funds" provided in section 89519. Each subsection thereof further clarifies the standards applicable to the various types of candidates who may have surplus funds.[10] Because Elections Code section 20300 no longer exists, staff believes authority does not exist to treat pre-'89 funds in the same manner under this subdivision. Instead, those funds are addressed below, in subdivision (e).

Subdivision (a)(1) identifies the date on which funds become surplus with respect to incumbent candidates. Because section 89519 provides two alternative dates for incumbent candidates,[11] the rule states that an incumbent's funds for that elective office become surplus on *the latter of either of two dates*: 1) the date he or she leaves office if the incumbent has not run for reelection or was defeated in the primary; or 2) the end of the postelection reporting period following his or her defeat.[12] In this scenario, funds belonging to a term-limited member of the State Assembly would become surplus on the day the incumbent leaves office. Also, if an incumbent member of the Assembly were to lose the party nomination in the primary election, the candidate's leftover funds would become surplus on the date he or she leaves office. If, on the other hand, that same Assembly candidate loses reelection in the November general election, his or her leftover funds would become surplus at the end of the postelection period following the November election. For the November general election, the end of the postelection reporting period is December 31 of the same year. (§ 84200, subd. (b).) The second sentence of the rule reminds candidates that these funds become surplus at this time *unless* the officeholder has opened a new committee for another office and has transferred the funds to that new committee.

Subdivision (a)(2) identifies the date on which funds become surplus with respect to non-incumbent defeated candidates and withdrawn candidates. In this respect, the funds become surplus at the end of the postelection reporting period following the candidate's defeat. Thus, if the candidate were defeated in a primary election in March, any unused campaign funds would become surplus on June 30th, the last day of the postelection reporting period for which the committee will file a report. (§ 84200, subd. (b).) For the November general election, the end of the postelection reporting period is December 31 of the same year. (*Id*.) By treating withdrawn candidates as defeated

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[10] The changes made in subdivisions (a)(1) and (2) from the earlier version adopted by the Commission in 1990 in regulation 18587 reflect only clarifying, non-substantive amendments.

[11] Subdivision (a) of section 89519 states, "Upon leaving any elected office, or at the end of the postelection reporting period following the defeat of a candidate for elective office, whichever occurs last, ..." (Underlining added.)

[12] This interpretation is consistent with staff interpretation in the past concerning the language of earlier draft regulation 18587, attached as Exhibit 3. (See Initial Statement of Reasons, Reg. § 18953.9, Rec'd by OAL 4/7/92.)

candidates, the regulation codifies staff advice on this issue.[13] If the candidate wishes to use the funds for his or her future election, the candidate must transfer the funds to a new committee prior to the date just described.

Finally, subdivision (a)(3) relates to deceased officeholders *and* candidates. The Commission is given two choices in how to treat these candidates. **Option A** treats a deceased candidate as a candidate who has left office according to section 89519. As a result, the candidate's funds become surplus immediately at the time of the candidate's passing. In contrast, **Option B** applies a rule similar to defeated candidates in subdivision (a)(2). Borrowing from the timelines established by the postelection reporting periods (ending June 30 and December 31), the funds would become surplus at the earlier dates of either June 30 or December 31 following the candidate's death.

The language in **Option A** reflects staff advice given in this area. In the *Mastrantonio* advice letter, No. I-91-561, staff advised that because the deceased candidate no longer was seeking office, the surplus funds provisions governed after the candidate died. [14] The language in **Option B** is optional language that would allow more time for the deceased candidate's committee to dispose of the funds under the less restrictive rules of sections 89510 through 89518. For instance, once funds become surplus a committee may no longer contribute those funds to other candidates for office in a California election nor contribute those funds to a political party committee for the purpose of supporting or opposing candidates for elective office. (§ 89519, subd. (b)(5).) Staff believes this option works to avoid the absurd or unnecessarily punitive result which would occur under **Option A**.[15]

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[13] In the *Willet* Advice Letter, *supra*, staff analogized a withdrawn candidate to a defeated candidate for purposes of section 89519, stating that "[i]f we were to construe Section 89519 to allow the supervisor's 1996 campaign account to continue as an active campaign account into perpetuity, this would be contrary to both the campaign bank account provisions of Proposition 73 which require that campaign bank accounts be tied to a specific election and Section 89519 which limits the use of campaign funds where they are not to be used for a pending election or in connection with a specific term of office."

[14] The *Bell* Advice Letter, No. A-00-10a, did not ultimately reach this conclusion but rather advised that the surplus funds provisions did not apply to the late Bernie Richter because his funds "were not surplus at the time of his death." This conclusion, without analysis, was based apparently on the candidate's decision prior to his death to abandon his election effort and he was in the process of returning contributions. Those checks had been mailed to certain contributors prior to Mr. Richter's death but had not been cashed.

[15] The Commission's authority to implement the intent of the Act, and not just the strict letter of the statute, is well established. In *Watson v. Fair Political Practices Commission*, 217 Cal.App.3d 1059, 1076 (1990), the court upheld regulation 18901 interpreting section 89001's statutory prohibition on newsletters and other mass mailings on the basis that the Commission had authority to "implement the intent and not the literal language of the statute." Here, section 89519 provides a "window" of time after the defeat of a candidate or after he or she leaves office to conclude the affairs of the committee and determine how leftover resources are to be used *before* the limitations of section 89519 become applicable. It seems unfair and unnecessary to penalize a deceased candidate's committee for the perhaps unforeseen circumstance of the candidate's death.

Staff Recommendation: Staff recommends the Commission keep both options in the prenotice text so that the public has an opportunity during the prenotice period to consider the options and provide input for the Commission to consider when it takes the matter up for adoption.

B. Subdivision (b) - Identifying the Postelection Period.

Subdivision (b) defines the "window period" between a candidate's defeat and the time a candidate's campaign funds become surplus, in which the candidate is permitted to use his or her campaign funds consistent with the personal use sections in section 89510 et seq. Defining "end of the postelection reporting period," this subdivision is consistent with the filing periods set forth in section 84200, subdivision (b), as indicated above in the discussion of subdivision (a) of the regulation.[16]

C. Subdivision (c) - When Funds are "Raised."

Because section 89519 only applies to funds "raised" after a certain date (either before or after January 1, 1989), the point at which campaign funds are raised takes on a special importance. The statute, however, does not define the term. For example, campaign funds could be considered raised at the time solicited, tendered, accepted or deposited by the candidate. Subdivision (c) of the regulation answers this question, stating campaign funds are "raised" upon "receipt," as disclosed on the candidate's campaign disclosure forms. This is consistent with the language of section 84211 of the Act, regulation 18421.1 and with the Commission's policy in 1990 with regard to former regulation 18587.

D. Subdivision (d) - Commingling Funds

Subdivision (d) establishes a presumption that where campaign funds raised prior to January 1, 1989, have been commingled with campaign funds raised after that date, the total amount in the campaign bank account will be presumed to have been raised after January 1, 1989. The presumption should simplify disposal of surplus campaign funds under the disparate system of pre- versus post- January 1, 1989, funds. This language embodies staff advice given in the *Craven* Advice Letter, No. A-97-373a. Staff recognizes, of course, that as time goes on this aspect of the regulation will be utilized less frequently as committees are terminated.

E. Subdivision (e) - Limit of Section 89519.

Subdivision (e) addresses the situation of the disposition of campaign funds belonging to campaign committees, for instance, candidate-controlled ballot measure committees, or pre- January 1, 1989, funds. In these cases, the regulation clarifies that the surplus funds rule of section 89519 will not apply. Staff proposes two options be

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[16] Neither the statute nor the regulation provides a "window period" for incumbents who voluntarily leave office or withdraw from an election campaign.

considered by the Commission. Language in **Option A** simply states the rule that section 89519 does not govern these funds. **Option B** goes further and states which rules *do* apply - i.e., the other personal use rules of sections 89510 et seq.

Option A leaves open the question of whether pre-1989 funds are governed by the Act at all. **Option B** would codify staff's view that without the reenactment of former Elections Code section 20300, the governing "personal use" law is encompassed in the general provisions of sections 89510-89518 and sections 89520-89522 apply. The latter are enforcement provisions.

Staff Recommendation: Staff recommends **Option B.**

III. OVERALL STAFF RECOMMENDATION

Staff recommends that the Commission approve draft regulation 18951 as discussed above for notice purposes so that work may proceed to adopt a regulation interpreting section 89519.

Attachments:

1. Government Code Section 89519
2. Draft Regulation 18951
3. Former Regulation 18587